

Metropolitan King County Council

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MANAGEMENT LETTER

DATE: March 30, 2005

TO: Metropolitan King County Councilmembers

FROM: Cheryle A. Broom, County Auditor

SUBJECT: Audit Findings of Washington State Auditor and Deloitte & Touche

This letter discusses our review of the most recent Washington State Auditor's Office (SAO) reports on King County, which cover the period from January 1, 2003 through December 31, 2003 and provide audit findings and recommendations on King County financial management and internal controls. Our review highlights certain of these SAO findings and is intended to assist the council in its oversight of corrective actions taken to address them.

Also, this letter discusses our review of an independent audit of the financial statements of the King County Public Transportation and Water Quality enterprises for the years ended 2002 and 2003.

Background:

The Washington State Auditor's Office is established by the state constitution as the auditor of all public accounts in the state. The office regularly conducts audits of 2,400 units of local government and is responsible for ensuring that public funds are properly accounted for and controlled, and that governments adhere to required laws and regulations relating to financial matters.

Each year, in October, the SAO releases the results of its review of King County's financial management during the previous year. The King County Auditor's Office (KCAO) reviews the SAO reports as part of its annual work program. When appropriate, the KCAO provides the council with comments regarding the SAO findings and recommendations and the adequacy of the county's response.

Covenants in bonds issued by the King County Transportation and Water Quality enterprises require an independent audit of the financial statements of the enterprises. Deloitte & Touche conducted these audits for the years ended 2002 and 2003.

Current Review:

The SAO issues two reports on King County each year. The first of these, the 'Report on Financial Statements and Federal Single Audit,' discusses the auditor's findings concerning its audit of the county's financial statements, and of the county's compliance with federal laws and regulations. The second of these, the 'Accountability Audit Report,' discusses the auditor's findings relating to the county's compliance with state laws and regulations.

Deloitte & Touche provides annual audits of the financial statements of the King County Public Transportation and Water Quality enterprises. Two reports issued by Deloitte & Touche report on audits of the enterprises' financial statements for the years ending December 31, 2002 and 2003.

Summary of 'Report on Financial Statements and Federal Single Audit'

The SAO issued an unqualified (or "clean") opinion regarding the county's financial statements for the year ended December 31, 2002. The SAO also reported four findings concerning the design or operation of internal control over major federal programs. Three of the findings are considered by the SAO to be material weaknesses. These findings are described below:

- **Finding 1.** The SAO found that charges against certain federal grants were not adequately supported by proper documentation of payroll and support costs. The SAO questioned \$782,531 charged to the Community Oriented Policing Services (COPS) grant and \$25,000 charged to the Weed and Seed Grant. This is a repeat finding from 2001 and 2002.
- **Finding 2.** The SAO found that the county had drawn down loans from the Capitalization Grant for Clean Water State Revolving Funds for unsupported costs, did not comply with reporting requirements, and owes back interest.
- **Finding 3.** The SAO found that the county did not obtain certification from its vendors showing they are not debarred or otherwise excluded from participation in federal programs.
- **Finding 4.** The SAO found that the county did not comply with reporting and supplanting requirements of the COPS Grant. The SAO questions \$246,424 in salaries charged to this grant, in that grant funds were used to pay for deputies who were hired in advance of the county's receipt of the grant.

Discussion and KCAO Recommendation: Actions taken by the county in response to these findings appear to have addressed the issues in the case of Findings 1 through 3. No repayments of questioned costs were required. These actions include the appointment of a grants coordinator within the Finance and Business Operations Division and changes to policies and procedures over grant management. The Sheriff's Office is currently working with the Department of Justice to resolve Finding 4. The Sheriff's Office indicates it had received verbal approval from the granting authority to hire additional deputies in anticipation of the grant, and is now working to receive written approval from the Department of Justice. However, written approval has not yet been received.

We recommend that the Sheriff's Office communicate to the council when a resolution is reached.

Summary of 'Accountability Audit Report'

The SAO reported no findings in its 2003 Accountability Audit Report.

Summary of Deloitte & Touche Financial Statement Audit for King County Public Transportation and Water Quality Enterprises

In concurrence with covenants in bonds issued by the King County Public Transportation and Water Quality enterprises, the accounting firm Deloitte & Touche is retained to conduct an independent audit of the financial statements of the enterprises. Deloitte & Touche issued an unqualified (clean) opinion on the accuracy of the financial statements for the enterprises for the years ending December 31, 2002 and 2003.

However, in a letter of recommendations, Deloitte & Touche noted a lack of effective internal controls governing the accounting and external financial reporting function that are considered by Deloitte & Touche to be material weaknesses. These weaknesses led to errors in financial reporting. These errors required 26 adjustments to be made within Transit's financial statements and 12 adjustments within Water Quality's financial statements. Although the errors were corrected, and the financial statements were fairly presented, Deloitte & Touche indicates that significant effort was required to correct the errors.

Deloitte & Touche recommended that King County address its concerns by either, (1) transferring the financial reporting function from the Finance and Business Operations Division to the enterprises, or (2) providing better oversight over financial reporting of the enterprises by the Finance and Business Operations Division.

Discussion

The material weaknesses of internal control over the financial reporting of the Public Transportation and Water Quality enterprises found by Deloitte & Touche are a concern. However, we note that many of the errors found by Deloitte and Touche involved mistakes in how assets were accounted for, which have little significance with respect to the overall financial position on the agencies. For example, completed capital projects were still being accounted for as work-in-progress rather than an operating asset. Nevertheless, it is important that the deficiencies in internal control identified by Deloitte & Touche be corrected as such weaknesses of internal control could lead to errors of greater significance.

The King County Finance and Business Operations Division has taken several actions in response to these findings including reallocating staff to provide greater emphasis on the oversight of financial reporting by the enterprises. However, it is too early to tell how well these actions will address the deficiencies reported by Deloitte & Touche.

We make no recommendation at this time; however, the auditor's office will monitor whether the corrective actions taken result in improvements in the accuracy of enterprise financial reporting.

Larry Brubaker, Principal Management Auditor, conducted this follow-up review. Please contact Larry at 296-0369 or me at 296-1655 if you have any questions about the issues discussed in this letter.

CB:LB:jl:SAO2003RptReview MLtr.doc

cc: Ron Sims, County Executive
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Steve Call, Director, Office of Budget and Management
Paul Tanaka, County Administrative Officer, Department of Executive Services
Bob Cowan, Director, Finance and Business Operations Division, Department of Executive Services
Dave Lawson, Internal Audit Supervisor, Executive Audit Services
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